

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2004-90-W/S – ORDER NO. 2006-292
MAY 5, 2006

IN RE: Application of Total Environmental Solutions,) SECOND ORDER ON
 Inc. (TESI) for Approval of an Adjustment of) REMAND
 Rates and Charges for Water and Sewer)
 Services.)

I. INTRODUCTION

This matter comes before the Public Service Commission of South Carolina (“the Commission”) on remand from the Order of the Circuit Court dated October 25, 2005, for the purpose of determining the appropriate single operating margin for Total Environmental Solutions, Inc. (“TESI”), based on the existing record of this case.

TESI is a Louisiana corporation providing water and sewer service to the Foxwood Hills resort community (“Foxwood Hills”) located on Lake Hartwell in Oconee County, South Carolina. TESI’s provision of utility service to its water and sewer customers in South Carolina is subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. § 58-5-10, *et. seq.* (1976), as amended. On March 17, 2004, TESI filed an application with the Commission seeking approval of a new schedule of rates and charges for water and sewer services provided to customers in Foxwood Hills. On May 18, 2004, Foxwood Hills Property Owners Association (“POA”), an entity comprised of property owners in Foxwood Hills, moved to intervene in this matter. Its intervention

was unopposed. On September 17, 2004, the Commission issued Order No. 2004-434 (“Initial Order”) establishing new rates to be phased in over a two year period in three installments. On October 11, 2004, TESI filed its Petition for Rehearing and/or Reconsideration (“Petition for Rehearing”) of the Initial Order requesting reconsideration of certain findings and conclusions in the Initial Order. The POA also filed its Petition for Reconsideration requesting reconsideration of the Commission’s Initial Order concerning disconnection of service. On January 14, 2005, the Commission issued Order No. 2004-574 (“Order on Reconsideration”) partially granting TESI’s petition and denying the POA’s petition. In its Order on Reconsideration, the Commission affirmed its decision from the Initial Order to implement the approved increase in three phases in order to lessen the “rate shock” to TESI’s customers. During the first phase, TESI would be allowed an operating margin of (7.75 %) with a net loss for return of (\$27,054). The second phase would allow an 11.71% operating margin with net income for return of \$64,183. Upon the implementation of the third and final phase, TESI would be allowed an ultimate operating margin of 20.00% with a net income for return of \$128,502.

On March 2, 2005, TESI filed a Petition for Judicial Review and appealed certain aspects of the Initial Order and the Order on Reconsideration to the Circuit Court.

On August 25, 2005, the Commission issued Order No. 2005-450 finding that TESI had posted a sufficient surety to put its rates under appeal into effect under bond pursuant to S.C. Code Ann. Section 58-5-240(D) (Supp. 2005). TESI has not yet put those rates into effect.

On September 12, 2005, the Circuit Court held a hearing on the appeal. On September 27, 2005, the Honorable James R. Barber, III issued an Order affirming the Commission with regard to the following issues: the elimination of expenses related to the unfilled field technician position; the disallowance of \$21,800 in affiliated services costs; rejection of TESI's proposed rate base correction; and the application of interest expense of \$4,195. The Circuit Court further held that the Commission cannot rely upon a phased-in approach to balance the interests of TESI and the public. The Circuit Court found that the Commission did not have the statutory authority to set three operating margins and three sets of rates in one proceeding, and the Circuit Court remanded the matter to the Commission to determine a single appropriate operating margin and rates.

On October 10, 2005, TESI filed a Motion to Alter or Amend Judgment with the Circuit Court and requested oral arguments from the parties on this Motion. On October 24, 2005, the Circuit Court heard oral arguments on TESI's motion. On October 25, 2005, the Circuit Court issued its Amended Order Ruling on Appeal of Public Service Commission Decisions. In this Amended Order, the Court amended its earlier order by expressly providing that it made no finding as to what an appropriate operating margin should be in this case. Other than this one addition, the Court made no other changes or additions to its earlier order. Thus, the Circuit Court's Amended Order contained the same conclusions as stated above in reference to the Circuit Court's Order of September 27, 2005.

Upon remand of this matter to the Commission, TESI requested that Commissioners Mitchell, Moseley and Clyburn, the original panel who initially heard the

case, also hear and rule on the remand in this matter. The POA and the Office of Regulatory Staff (“ORS”)¹ agreed with TESI that the panel who originally heard the case should also hear and rule on the matter on remand. On January 23, 2006, the Commission issued Order No. 2006-51, designating the original panel of three Commissioners to consider the remand and rule on the case.

On January 24, 2006, the original panel of three Commissioners heard oral arguments in this matter with respect to what action should be taken as a result of the remand. John F. Beach, Esquire, represented TESI; Frank R. Ellerbe, III, Esquire, represented the POA; and Florence P. Belser, Esquire, General Counsel and Wendy B. Cartledge, Esquire represented the ORS.

On February 8, 2006, the Commission issued Order No. 2006-89, First Order on Remand, ordering that the parties file briefs and proposed orders, citing to the record, setting out the parties’ positions as to the appropriate single operating margin.

The case is now before the Commission to rule on the remand from the Circuit Court. Accordingly, we will follow the dictates of the Circuit Order and issue this Order on Remand.

¹ The Consumer Advocate for the State of South Carolina (“Consumer Advocate”) was an intervenor in the original case in 2004. However, with passage of 2004 S.C. Act No. 175, the Consumer Advocate’s statutory authority to represent the public interest in cases involving public utilities was rescinded, and the Office of Regulatory Staff (“ORS”) was authorized to appear as a party in cases before the Commission, and to appear in any cases on appeal pending on January 1, 2005. See S.C. Code Ann. §37-6-604(C) (Supp. 2005) which provides that “[a]fter January 1, 2005, the [Consumer Advocate] division must not represent consumers in matters arising under Title 58. Matters or appeals under Title 58 that are pending on January 1, 2005, shall be transferred to the Office of Regulatory Staff.”

II. FINDINGS OF FACT

1. TESI is a water and sewer utility providing water and sewer service in its assigned service area within South Carolina, and its operations in South Carolina are subject to the jurisdiction of the Commission, pursuant to S.C. Code Ann. Section 58-5-10 et seq. (1976 & Supp. 2005).

2. This matter is before the Commission on remand from the Circuit Court. Pursuant to the Circuit Court's Order, the only issue before the Commission is the determination of the appropriate single operating margin for TESI and rates to produce the operating margin.

3. TESI is seeking an increase in its rates and charges for water and sewer services equal to \$538,490 of additional revenues.

4. The Commission concludes that a fair operating margin is 12.75%. Using an operating margin of 12.75% with expenses found just and reasonable by the Circuit Court in its orders, TESI will require total operating revenues of \$522,681. The rates to produce the service revenues are listed in Appendix A attached hereto and made a part hereof by reference.

III. EVIDENCE TO JUSTIFY FINDINGS OF FACT

In this section, the Commission sets forth the evidence relied upon in making its Findings of Fact as set forth in Section II of this Order.

1. EVIDENCE FOR FINDING OF FACT NO. 1

The evidence supporting this finding concerning the Company's business and legal status is contained in the Application filed by TESI, in the testimony of TESI witness Paul

Maeder, and in prior Commission Orders in the docket files of the Commission, of which the Commission takes judicial notice. By the Application, TESI admits that it is a public utility within the meaning of S.C. Code Ann. Section 58-5-10(3) (Supp. 2005) and that it is providing sewer services to 543 customers and water services to 561 customers in Foxwood Hills. This finding of fact is essentially informational, procedural and jurisdictional in nature, and the matters which it involves are not contested by any party.

2. EVIDENCE AND CONCLUSIONS FOR FINDINGS OF FACT NO. 2

In the present case, the Commission must determine an appropriate single operating margin and current rates. The Commission's original ruling had attempted, by its gradual phase-in of a rate increase, to balance the interests of TESI in earning a fair return with the interests of the customers in avoiding the rate shock resulting from an immediate substantial rate increase. The Circuit Court held, however, that, pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2005), the Commission does not have statutory authority to set three operating margins and three sets of rates in one proceeding. *See* "Amended Order Ruling on Appeal of Public Service Commission Decisions," October 25, 2005, p. 7.

The Circuit Court affirmed the Commission's findings with respect to the following issues: the elimination of expenses related to an unfilled field technician position; the disallowance of \$21,800 in affiliated services expenses; rejection of TESI's proposed rate base correction; and the application of interest expense of \$4,195. (*See* Circuit Court's "Amended Order Ruling on Appeal of Public Service Commission Decisions," October 25, 2005, pp. 3-6).

The Circuit Court rejected TESI's argument that the Court should order that TESI is entitled to rates which will produce an operating margin of 20.00%, and the Court expressly stated in the October 25, 2005 Amended Order that the Court made no finding as to the level of an appropriate operating margin in this case (*See* Circuit Court's "Amended Order Ruling on Appeal of Public Service Commission Decisions," October 25, 2005, pp.6-9)

3. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 3

The evidence for the finding concerning the amount of the requested rate increase is contained in the Application filed by TESI and in the testimony and exhibits of Commission Staff witness William O. Richardson. The Application filed by TESI indicates that it is seeking additional revenues of \$540,065 from the proposed rates for its water and sewer operations. Application of TESI, Exhibits B and C. Additionally, Commission Staff witness Richardson testified that under the rates proposed in the Application, as calculated and adjusted by the Commission Staff, TESI would see an increase in revenues of \$538,490. Hearing Exhibit No. 9 (Utilities Department Exhibit No. 2).

We adopt Staff's calculation of the increase in revenues because the Staff's calculation appropriately reflects annualized charges for water and sewer service. Staff's adjustment to annualize the rates recognizes revenues for water and sewer service for a full year under the approved rates. We find that the annualized revenues as calculated by the Staff to be appropriate to use in establishing rates. Therefore, the Commission finds that TESI is seeking an increase in its revenues of \$538,490.

4. EVIDENCE AND CONCLUSIONS FOR FINDING OF FACT NO. 4

The determination of a fair operating margin is peculiarly within the province of the Commission. Hamm v. South Carolina Public Service Commission, 309 S.C. 295, 422 S.E.2d 118 (1992); Seabrook Island Property Owners Ass'n v. South Carolina Public Service Commission, 303 S.C. 493, 401 S.E.2d 672 (1991). The Commission is recognized as the expert designated by the legislature to make policy determinations regarding utility rates. Patton v. South Carolina Public Service Commission, 280 S.C. 288, 312 S.E.2d 257 (1984).

The Commission finds a fair operating margin for TESI operations is 12.75%. The documentation provided in this case, along with the standards of ratemaking, substantiates the need for a rate increase. The Commission must allow for the utility to be viable in order to provide the services to the public. However, while the Commission recognizes a need for increased rates and increased revenues by TESI, the Commission is not without sympathy for the customers. The Commission recognizes that the customers are being requested to pay a sizeable increase for water and sewer service.

The Commission recognizes that it must consider the value of the services provided as well as recognizes that there is a limit to what the public can bear. The Commission must strike a balance between the revenue needs of the utility and the value of the service to the public. While keeping in mind the financial status and viability of TESI, the Commission does not ignore the impact of rate increases on the public. In light of these factors and based upon the record in the instant proceeding, the Commission

concludes that a reasonable and fair operating margin which TESI should have an opportunity to earn is 12.75%.

In his Direct Testimony, TESI witness Gary D. Shambaugh, Executive Vice President, AUS Consultants-Weber Fick & Wilson Division, testified that TESI utilized a 12.75% operating margin for both the water and sewer operations. (Tr. dated 8/24/2004, p. 176, ll. 4-6).² Mr. Shambaugh testified that a reasonable margin of cash flow above normalized operations was necessary for TESI to provide for emergency situations, attain financial viability, and have the ability to secure long-term debt at a reasonable cost rate (Tr. dated 8/24/2004, p. 176, ll. 11-15).

Mr. Shambaugh defined operating margin as the margin of revenue over and above expenses (Tr. dated 8/24/2004, p. 293, ll. 13-20). Mr. Shambaugh recommended that the Commission adopt the operating expenses proposed by TESI and TESI's operating margin of 12.75% (Tr. dated 8/24/2004, p. 297, ll. 3-5).

In determining the appropriate operating margin, the Commission must balance the interests of TESI and its customers. The governing principle for determining rates is the right of the public on one hand to be served at a reasonable charge, and the right of the utility on the other to a fair return on the value of its property used in the service. So. Bell Telephone & Telegraph Co. v. Public Service Commission of South Carolina, 270 S.C. 590, 595, 244 S.E. 2d 278, 281 (1978) quoting 64 Am. Jur. 2d, Public Utilities, §189. The Commission is charged with balancing the respective interests of the company and consumer by approving rates which are just and reasonable, not only producing

² The Transcript is referenced by date since the transcript does not contain a Volume number. Pages are cited to the page numbers stamped at the top of each transcript page.

revenues and an operating margin within a reasonable range, but which also distribute fairly the revenue requirements, considering the price at which the company's service is rendered and the quality of that service. Seabrook Island, *supra*. See also Bluefield Water Works & Improvements Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923). In rate cases, "the Public Service Commission is recognized as the 'expert' designated by the legislature to make policy determinations regarding utility rates." Patton at 291. In its capacity as rate maker, "the Commission sits as the trier of the facts, akin to a jury of experts." Hamm v. South Carolina Public Service Commission, 294 S.C. 320, 322, 364 S.E.2d 455, 456 (1988). The Commission does not have to arrive at the appropriate operating margin based on any expert testimony. Kiawah Property Owners Group v. Public Service Commission of South Carolina, 359 S.C. 105, 597 S.E.2d 145 (2004).

Under the guidelines established in the decisions of Bluefield and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944), this Commission does not ensure through regulation that a utility will produce net revenues. As the United States Supreme Court noted in the Bluefield decision, the utility "has no constitutional rights to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures." However, employing fair and enlightened judgment and giving consideration to all relevant facts, the Commission should establish rates which will produce revenues "sufficient to assure confidence in the financial soundness of the utility and ... that are adequate under efficient and economical management, to maintain and support its credit

and enable it to raise the money necessary for the proper discharge of its public duties.”
Bluefield, *supra* at 692-693.

In the present case, the Commission has determined the appropriate adjustments to expenses in our Initial Order and our Order on Reconsideration. Those adjustments to expenses were not remanded by the Circuit Court and are therefore not to be disturbed in this order. Based on the adjustments the Commission approved in its Initial Order and its Order on Reconsideration, TESI’s adjusted operating expenses are \$451,834. The Commission finds that TESI should have an opportunity to earn a 12.75% operating margin. An operating margin of 12.75% will allow TESI a margin of profits after payment of all expenses found just and reasonable for ratemaking purposes in the Initial Order and the Order on Reconsideration. This 12.75% operating margin balances the interest of the utility with the interests of the consumers by providing a reasonable profit for the utility while ensuring that the consumers pay a reasonable rate for the services provided.

In order for TESI to earn a 12.75% operating margin, TESI will need to charge rates producing \$519,700 in revenues. Our calculation of revenues utilizing a 12.75% operating margin and expenses of \$451,834 as approved in the Initial Order and the Order on Reconsideration is shown in the following table:

TABLE A

Service Revenues	\$	519,700
Miscellaneous Revenues	\$	<u>2,981</u>
Total Operating Revenues	\$	522,681
Operating Expenses	\$	<u>451,834</u>
Net Operating Income/Loss	\$	<u>70,847</u>
Add: Customer Growth		<u>0</u>
Operating Margin Interest Expense	\$	<u>4,195</u>
OPERATING MARGIN		<u>12.75%</u>

Based upon the level of operating expenses approved in the Initial Order and the Order on Reconsideration, total revenues in the amount of \$522,681 are required for TESI to have the opportunity to achieve a just and reasonable operating margin of 12.75%. We hereby grant an increase in water and sewer rates to produce additional revenues for TESI of \$269,757. These rates are shown in Appendix A attached to this Order which is incorporated herein by reference. The Commission finds and concludes that the rates and charges approved herein achieve a balance between the interests of TESI and those of its customers.

It is incumbent upon the Commission to approve rates which are just and reasonable, not only producing revenues and an operating margin within a reasonable range, but which also distribute fairly the revenue requirements, considering the price at which the company's service is rendered and the quality of the service. *See* S.C. Code Ann. Section 58-5-290 (1976). TESI's witness testified at the hearing that if the Commission accepted staff adjustments, the company's pro forma operating expenses would be reduced and the Commission should grant TESI a higher operating margin. Tr. dated 8/24/2004, pp. 294-297. *See also* TESI witness Paul Maeder's testimony: Tr. dated

8/24/2004, p. 155 and Commission Staff Witness Richardson's testimony: Tr. dated 8/24/2004, pp. 110-111). The testimony of TESI witness Shambaugh indicates that TESI seeks to recover a set revenue objective regardless of the level of operating expenses found reasonable and approved by the Commission. We reject TESI's witness testimony that TESI has a right to earn a certain level of revenues without respect to the company's level of adjusted operating expenses or operating margin. As explained in the discussion below, adoption of the position espoused by the witness for TESI would negate the authority of this Commission to determine the appropriate amount or level of expenses which are to be charged to the ratepayers through rates.

Following the filing of the Staff's direct testimony in which the Staff proposed certain adjustments to TESI's test year operations, TESI's witness filed rebuttal testimony in which he asserted that should the Commission adopt the Staff's recommended adjustments then the Commission should grant an operating margin in the range of 18% to 20%. (Tr. Dated 10/24/04, p. 209-210) While the Commission indeed accepted many of the Staff's recommended accounting adjustments, the Commission rejects TESI's contention that the company is entitled to a larger operating margin than 12.75%. (Tr. dated 10/24/04, pp. 209-210, 294-297 and Hearing Exhibit 10). The Commission has already determined the proper adjustments to the rate base and to operating expenses in the Initial Order and the Order on Reconsideration.

In ruling on the accounting adjustments to expenses and rate base, we examined the testimony of both the TESI witnesses and the Commission Staff witnesses regarding proposed adjustments to some expenses, and we eliminated expenses which were not

used and useful to provide service, which were not known and measurable, or which were otherwise disallowed pursuant to ratemaking scrutiny as part of our analysis which resulted in the issuance of the Initial Order and the Order on Reconsideration. (Tr. dated 10/24/04, pp. 109-110). It is within the Commission's statutorily delegated power to determine the amount of an expense that will be charged to the ratepayers. Seabrook Island, *supra*. Adjustments for known and measurable changes in expenses are within the discretion of the Commission. Porter v. South Carolina Public Service Commission, 328 S.C. 222, 230, 493 S.E.2d 92, 97 (1997). In its Initial Order and Order on Reconsideration, the Commission disallowed certain expenses as not being recoverable in rates, and the Circuit Court affirmed the adjustments which TESI appealed. To allow TESI an increased operating margin of 18% to 20% on the basis that the Staff's accounting adjustments decreased operating expenses below the level requested by TESI has the effect of providing recovery of expenses which the Commission expressly disallowed in the Initial Order and the Order on Reconsideration. Further, to allow TESI to recover additional revenues from an increased operating margin based on the amount of expenses disallowed would nullify the authority of the Commission to make adjustments to expenses and would in effect reverse the decision of the Commission in finding those expenses not allowable for ratemaking purposes.

IT IS THEREFORE ORDERED THAT:

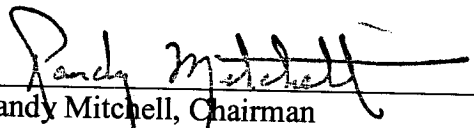
1. The Commission hereby affirms all of the findings and conclusions of its prior Orders, except as modified herein.

2. A fair operating margin that TESI should have an opportunity to earn is 12.75%.

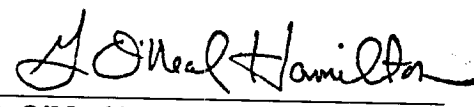
3. The schedule of rates and charges attached hereto as Appendix A is hereby approved for service rendered on or after the date of this Order. Further, the schedules are deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2005).

4. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:


Randy Mitchell, Chairman

ATTEST:


G. O'Neal Hamilton, Vice Chairman

(SEAL)